



February 15, 2013

Robert deV. Frierson  
Secretary  
Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue NW.  
Washington, DC 20551.

Dear Secretary Frierson:

The American Bankers Association<sup>1</sup> and The Financial Services Roundtable,<sup>2</sup> (together, the Associations) appreciate the opportunity to comment on the scenario development policy statement (the Policy Statement)<sup>3</sup> issued by the Board of Governors of the Federal Reserve System (the Board).

The stress test rules<sup>4</sup> and the Board's capital plan rule<sup>5</sup> require the Board and financial institutions to calculate pro-forma capital levels—rather than “current”—over a specified planning horizon under baseline and stressed scenarios. For these purposes, the Dodd Frank Act requires the Board, and the other banking agencies, to provide at least three different sets of scenarios: baseline, adverse, and severely adverse.

To enhance the transparency of the scenario design process, the Policy Statement outlines the characteristics of the stress test scenarios and states the considerations and procedures that underlie the formulation of these scenarios for the stress testing and the capital plan rule. The Board plans to develop the annual set of scenarios in consultation with the Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation (collectively the

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<sup>1</sup> The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's \$14 trillion banking industry and its 2 million employees. Learn more at [www.aba.com](http://www.aba.com).

<sup>2</sup> The Financial Services Roundtable represents 100 integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO.

Roundtable member companies provide fuel for America's economic engine, accounting directly for \$98.4 trillion in managed assets, \$1.1 trillion in revenue, and 2.4 million jobs.

<sup>3</sup> 77 FR 70124 (November 23, 2012).

<sup>4</sup> 12 CFR 252 subpart H and F.

<sup>5</sup> 12 CFR 225.8.

Agencies) to reduce the burden that could arise from having the Agencies establish inconsistent scenarios.

The Associations greatly appreciate that the Board elected to publish the Policy Statement and seek the industry's comments. Indeed, the Associations have concerns about several components of the Policy Statement, as discussed in more detail below.

**The Agencies should coordinate to provide identical stress test scenarios to depository institutions and bank holding companies.**

Under Section 165(i)(2) of Dodd-Frank and the stress testing rules, bank holding companies with over \$10 billion in assets are required to conduct company-run stress tests. The company-run stress test requirement is also separately applicable to depository institutions having over \$10 billion in assets, whether they are national banks, state member banks, or state non-member banks. With respect to depository institutions, the Federal Reserve supervises company-run stress tests for state member banks, the OCC would supervises stress tests under its own rules<sup>6</sup> for OCC regulated entities pursuant to Section 165(i)(2) of Dodd-Frank, and the FDIC does so for state non-member banks.<sup>7</sup> The Associations are concerned that the Agencies may issue different stress scenarios. This concern is the result of the separate 165 stress testing proposals and rules, separate scenario statements, and the different descriptions of how/if operational risk will be captured in the scenarios. Most banking organizations are structured with a bank holding company and at least one subsidiary depository institution. Using one set of stress scenarios at the bank holding company level and a different stress scenario at the subsidiary depository institution(s) would be needlessly complex and burdensome. Moreover, any public disclosure of divergent results within a bank holding company would be both confusing and of little value to investors and other market participants. As a result, we urge the Agencies to develop consistent stress test scenarios.

**The Agencies should provide scenarios to institutions earlier to *enhance institutions'* internal governance of the results.**

The Board has historically provided the scenarios to institutions in mid- to late-November, only six to seven weeks for implementation and calculation prior to the submission deadline. During this abbreviated time frame that begins upon receipt of the scenarios, firms are obligated to analyze them; disseminate them throughout their organizations; model cross-enterprise results; apply appropriate oversight in the consistency, reasonableness, and comprehensiveness of the scenario results; seek approvals for stress tests and capital plans from working groups, management committees, and Board committees or full Boards of Directors; and fully document their results and methodologies for submission.

We understand that the Agencies have a general interest in providing the scenarios as late as possible in order to ensure that the scenarios are relevant to the macroeconomic environment. In other words, the Agencies may be concerned that the environment may change after the provision of scenarios if the scenarios are released too far in advance. However, it should be recognized that the relevant period for the capital actions request is covered within the first five quarters of the forecasting period starting from the fourth quarter of the current year (e.g.,

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<sup>6</sup> See 12 CFR 46.

<sup>7</sup> See 12 CFR 325, Subpart C.



December 31, 2012) and ending at the first quarter of the following year (e.g., March 31, 2014). The Agencies will provide updated scenarios in the next CCAR process, and have the ability to require updated submissions if the macroeconomic environment changes abruptly.

As a result, providing the scenarios several weeks earlier would have minimal potential cost to the relevance of the scenarios, considering the context of an eighteen-month coverage period. Balanced against such minimal cost would be the benefit of enabling institutions more fully, thoroughly, and carefully to conduct their stress tests. Even providing the scenarios to institutions only two weeks earlier (e.g., the beginning of November) would extend the time institutions have to conduct their stress testing properly and to apply appropriate governance by 25-30 percent. It is in everyone's interest that the stress testing and capital planning process be as robust as possible, and presently it is severely constrained by the timing of the receipt of the scenarios.

**The Agencies should adopt an approach for developing supervisory stress scenarios that leads to predictable, complete, and reasonable scenarios.**

In many respects, the Policy Statement is a positive step that will add predictability and reasonableness to the stress testing process. This is particularly true for the severely adverse scenario which is constrained to historical events. However, similar to the severely adverse scenario, variables in the adverse scenario must be constrained so that changes in the adverse scenario do not change drastically from year to year (except where those changes are based upon identified material emerging risks not captured in adverse historical precedents).

One possible way to add predictability to the adverse scenario is to limit the range of fluctuation based on historical data. The Associations understand that the Agencies want flexibility in developing the adverse scenario. However, it is possible to have flexibility within a framework. The Agencies could select a number of historical macroeconomic events and derive the variables from a combination of the historical events. These historical economic events could include:

- A standard recession (e.g., the 1990-1991 recession);
- A stagflation event (e.g., stagflation during 1974);
- An emerging markets crisis (e.g., the Asian currency crisis of 1997-1998);
- An oil shock (e.g., the shock during the run up to the 1990-1991 recession); And
- High inflation (e.g., the inflation pressures of 1977-1979)

By deriving the variables of the adverse scenario from a number of historical events, the variables would fluctuate within a more predictable range. Such an approach would reduce potential volatility and provide greater predictability in the amount of capital that companies are required to hold.

In addition, one aspect of the Policy Statement that reduces predictability is the indication that scenarios would vary in relation to "...changes in the outlook for economic and financial conditions and changes to specific risks or vulnerabilities..." The Associations recommend that there be communications in advance of the release of the scenarios as to what these specific risks or vulnerabilities may be.

**The Agencies should provide a more detailed written description of the adverse and severely adverse scenarios.**

The scenarios published by the Agencies for 2013 contained only a brief written description of the economic conditions described in each scenario. We recommend that the banking agencies provide more description around the adverse and severely adverse scenarios in order to aid firms in developing a deeper understanding of the economic situation that the data describes, including the relationships between and among variables. This need is heightened to the extent the scenarios do not derive from observable historical events or are a combination of historical events that have not heretofore occurred simultaneously. This request recognizes that, in order to conduct stress tests, firms must construct more data points than what the banking agencies have provided. Indeed, the Policy Statement recognizes that a firm may add additional variables and states the Board's expectation that the paths of any additional variables be consistent with the scenarios provided. Without a deeper understanding of the economic conditions giving rise to the variables and the relationships among different variables, producing the assumptions necessary to construct additional data points is more difficult and could lead to inconsistent assumptions and data points across banks. In order to achieve a higher level of consistency, we recommend the banking agencies provide a more detailed description about each of the adverse and severely adverse scenarios.

**The Agencies should provide clarity on how they developed certain variables and provide new variables where appropriate.**

The Agencies should provide clarity on how they developed the international assumptions and should provide additional country specific variables

Similar to its recession-based approach for the United States, the supervisory assumptions for international variables should be consistent with historical data. Further, the Board should clarify how it developed its international assumptions to increase the transparency and consistency of the scenarios.

In addition, the Board should provide country-specific variables beyond the set that has been included in the past. An expanded and standardized set of international variables would enhance the consistency among institutions. For the existing set of international countries, unemployment series, equity markets, and home values would be welcome additions. Further, instead of using regional aggregate variables for "developing Asia," the Board should list individual assumptions for the component countries. The Board should also provide specific variables for countries in which internationally active banks often have concentrations. For example, supervisory economic scenarios have not historically included any indicators for Latin America, a region in which U.S. banks have substantial business. As a starting point, it would be useful for the supervisory scenarios to include assumptions for Mexico and Brazil. Other countries to consider adding include Canada, Australia, Singapore, Poland, and Russia.

The Agencies should provide the market shock variable to all banks

The summary template of the FR Y-14A requires all banks to conduct a market shock test for their available-for-sale securities. However, the market shock variable is only provided to banks with significant trading activity. In effect, banks with limited trading activity need to use their best judgment and develop their own, unique, market shock variable. In order to maintain



consistency across institutions, the Agencies should provide the market shock variable to all institutions as part of the annual CCAR Instructions release.

The Agencies should provide additional variables

In addition to the variables currently provided we urge the agencies to provide the listed variables in Appendix A. In addition, we urge the Board to provide the factors used in their own models. This would increase consistency of scenario assumptions amongst industry participants, comparability of results, and better ensure that macro prudential regulation is being addressed. Furthermore, it would be valuable to banks whose results are disclosed to aid reconciling differences between internal and Board results for Regulators and Bank Board of Directors.

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Thank you for considering the concerns raised in this letter. We appreciate the opportunity to share our views and would be happy to discuss any of them further at your convenience. If you have any questions, please contact Hugh C. Carney, Senior Counsel of the American Bankers Association at (202) 663-5324 (e-mail: [hcarney@aba.com](mailto:hcarney@aba.com)); or, Richard Foster, Senior Counsel of the Roundtable at (202) 589-2424 (e-mail: [richard.foster@fsround.org](mailto:richard.foster@fsround.org)).

Sincerely,



Hugh C. Carney  
Senior Counsel II



Richard M. Whiting  
Executive Director & General Counsel

**Appendix -** The following is a list of variables that many banks use for their own internal processes and the Associations believe would be beneficial for the Board to provide.

<b>First Tier</b>	<b>Variable</b>	<b>Description</b>
1	Fed Funds Rate	Overnight Fed Funds rate - represent averages for the quarter
2	3-mo LIBOR Rate	LIBOR Rates: 3-Month U.S. Dollar Deposits, (% P.A., NSA)
3	2yr-Treasury Rate	Federal Reserve Release (FRSR) H.15 - represent averages for the quarter
4	5yr-Treasury Rate	Federal Reserve Release (FRSR) H.15 - represent averages for the quarter
5	Crude Oil Price	NY Mercantile Exchange - WTI crude oil traded in dollar per barrel
6	Natural Gas Price	NY Mercantile Exchange - Natural gas traded in dollar per MMBTU

<b>Second Tier</b>	<b>Variable</b>	<b>Description</b>
1	Credit Card Delinquencies	Delinquency Rate On Credit Card Loans, All Commercial Banks (DRCCCLACBN)
2	Auto Delinquency	ABA Delinq. Rate: Auto Indirect Loans (% of \$ 30+ DPD) (FABAAIVOL)
3	Bank Card Delinquency	ABA Delinq. Rate: Bankcard (% of \$ 30+ DPD)(FABABCVOL)
4	Retail Sales	Retail Sales: Retail Sales and Food Services, (Bil. \$, SAAR)
5	HELOC Volume	Assets: Commercial Banks - Revolving Home Equity Loans, (Bil. \$, SA)
6	MSCI International Equity	International Equity Index MSCI EAFE
7	Consumer Confidence	Conference Board Consumer Confidence SA (1985=100)
8	FHFA Home Price Index	FHFA All Transactions Home Price Index; (Index; 1980Q1 = 100; NSA)(FHOFHOPI)
9	Unemployment Rate	Household Survey: Unemployment Rate; (%; SA) (FLBR)
10	Mortgage Delinquency	MBA: Loans Past Due 90 Days - Total, (Unit %, SA)(FMBAD90)
11	Mortgage Foreclosure Starts	MBA: Foreclosures Started - Total, (Unit %, SA) (FMBAFS)
12	BAA Spread	BAA Spread
13	Residential Permits	Permits: Residential - Total, (Mil., SAAR)(FHPNR)
14	Value of Construction	Value of Construction Put in Place: Total; (Bil. \$; SAAR)(FCPTC_US)

<b>Second Tier</b>	<b>Variable</b>	<b>Description</b>
15	Property Index	NCREIF Property Index: Rates of Return; (%) (FNCREIFPIRQ_US)
16	World GDP	World GDP
17	Secondary Mortgage Rates	Secondary Mortgage Rates
18	Manheim Used Vehicle Price index	Manheim Used Vehicle Price Index
19	Bankruptcy	Bankruptcy
20	Commercial real estate price index	Commercial Real Estate Index
21	Index of Builder Sentiment	Index of Builder Sentiment (NAHB)
22	Non-defense capital goods orders	Non-defense capital goods orders – excluding aircraft (Commerce Dept.)
23	Composite HPI	Case-Shiller® Monthly Home Price Index: 20-metro composite; (Index 2000Q1=100; SA) (FHCSHP1TI20Q_US)
24	Manheim Used Vehicle Price index	Manheim Used Vehicle Price index
25	Durable goods	NIPA: Personal Consumption Expenditures - Durable Goods, (Bil. \$, SAAR)
26	Emerging Market Equity Index	Emerging markets equity index (MSCI EM)
27	Household debt service ratio (DSR)	Household debt service ratio
28	Financial obligations ratio	Adds automobile lease payments, rental payments on tenant-occupied property, homeowners' insurance, and property tax payments to the debt service ratio.
29	Corn price	Corn Price Index
30	Consumer spending	Real Consumer Spending in \$s and percentage growth
31	Initial weekly jobless claims	Initial weekly jobless claims
32	Light vehicle sales	new car and light truck sales

<b>Third Tier</b>	<b>Variable</b>	<b>Description</b>
1	Housing Starts (Millions)	Bureau of Census - new housing units started, seasonally adjusted annual rates.
2	Existing Home Sales	Existing Home Sales: Single-Family, (Mil., SAAR)
3	Total Employment	Bureau of Labor Statistics - total employed in civilian work force
4	Labor Participation Rate	Labor Force Participation Rate: Working-Age Population, (% , SA)
5	1-mo LIBOR Rate	LIBOR Rates: 1-Month U.S. Dollar Deposits, (% P.A., NSA)
6	12-mo LIBOR Rate	LIBOR Rates: 1-Year U.S. Dollar Deposits, (% P.A., NSA)
7	3-yr Swap	3Y Constant Maturity Swap Rate
8	7-yr Swap	7Y Constant Maturity Swap Rate
9	30-yr Treasury Rate	Interest Rates: 30-Year Constant Maturity Securities, (% P.A., NSA)
10	Regional HPI	Case-Schiller - Various
11	Purchase/Refinance %	Mortgage Originations: 1-4 Family - Purchase/Refinance, (Bil. USD, SAAR)
12	Prime Rate	Interest Rates: Bank Prime Rate, (% P.A., NSA)
13	Baa Corporate %	Interest Rates: Moody's Bond Yield - Baa Corporate, (% P.A., NSA)(FRBAAC_US)
14	Aaa Corporate %	Interest Rates: Moody's Bond Yield - Aaa Corporate, (% P.A., NSA)
15	Jumbo Mortgage Rates	Additional Mortgage Rates (e.g. Jumbo)